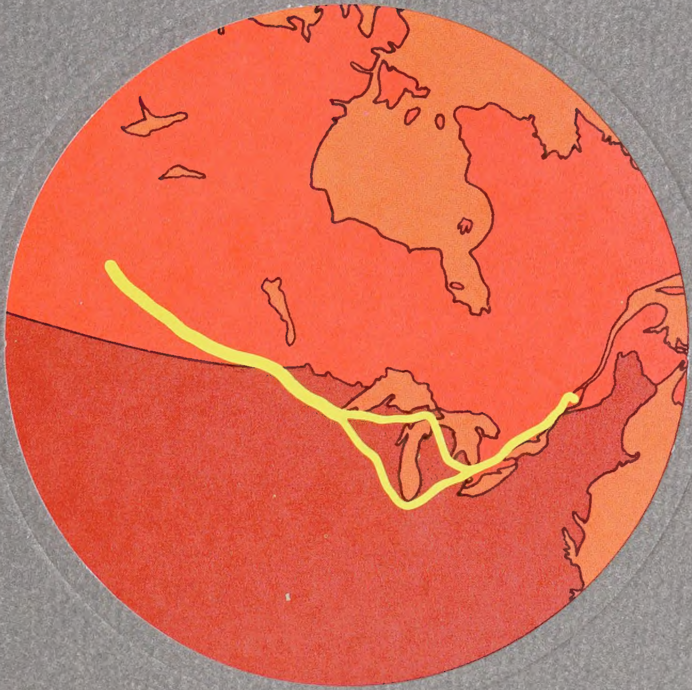
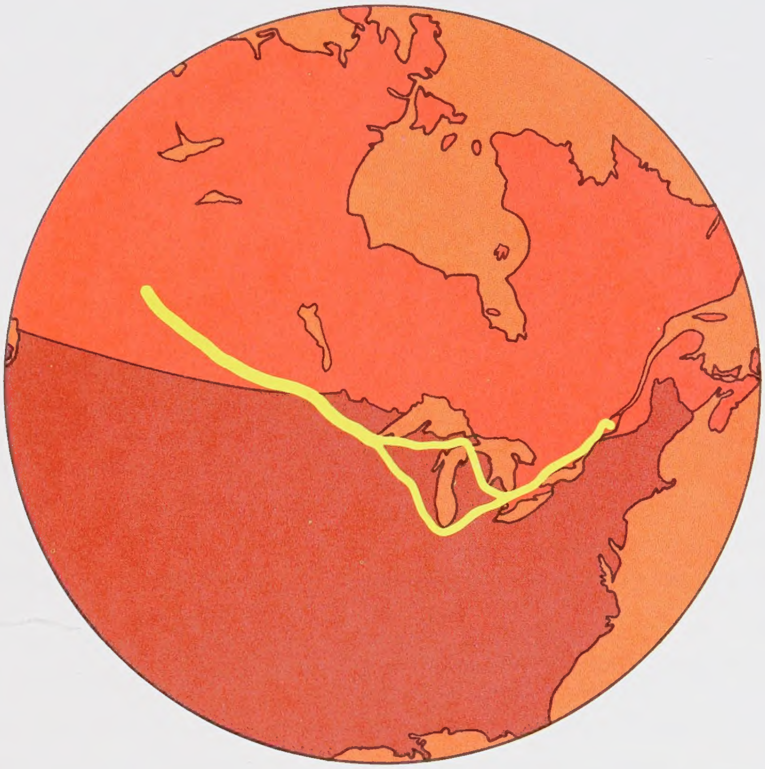
INTERPROVINCIAL PIPE LINE LIMITED ANNUAL REPORT 1978







## ANNUAL MEETING

2:30 p.m. Wednesday, April 11, 1979, "Toronto III" Room, Hotel Toronto, 145 Richmond Street West, Toronto.

The Notice of Meeting, Information Circular and form of Proxy are being mailed with this report to all shareholders of record on March 19, 1979.

## CONTENTS

# HIGHLIGHTS

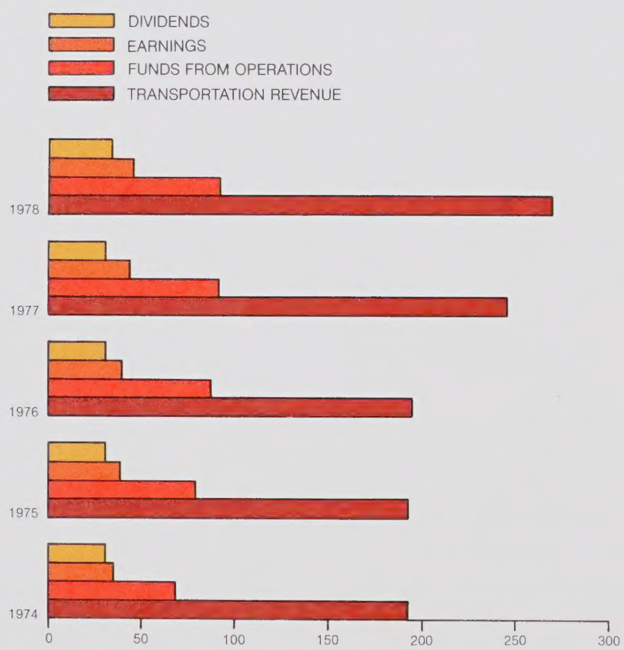
## FINANCIAL

| | 1978 | 1977 | Percentage Increase |
|---|---|---|---|
| Transportation revenue | $269,989,000 | $245,699,000 | 10% |
| Deficiency Agreement | $ 16,766,000 | $ 28,988,000 | |
| Other income | $ 7,723,000 | $ 4,766,000 | |
| Expenses, excluding taxes | $178,908,000 | $174,983,000 | 2% |
| Income and other taxes | $ 68,760,000 | $ 60,623,000 | 13% |
| Earnings | $ 46,810,000 | $ 43,847,000 | 7% |
| per share | $1.83 | $1.71 | |
| Dividends | $ 34,524,000 | $ 30,688,000 | 13% |
| per share | $1.35 | $1.20 | |
| Capital expenditures | $ 9,413,000 | $ 20,197,000 | |
| Funds provided from operations | $ 93,258,000 | $ 91,907,000 | |

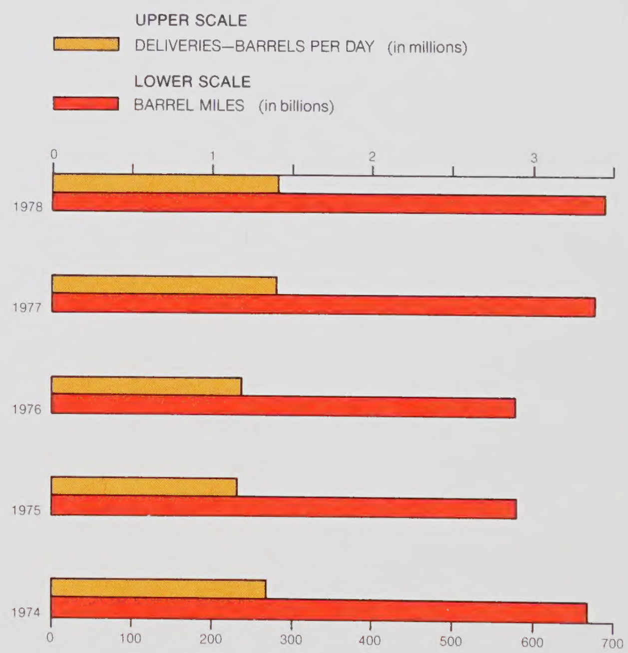
## STATISTICAL

| | 1978 | 1977 | Percentage Increase |
|---|---|---|---|
| Deliveries (barrels per day) | | | |
| By Quarters | | | |
| First | 1,424,835 | 1,452,931 | |
| Second | 1,365,639 | 1,405,174 | |
| Third | 1,338,233 | 1,310,110 | |
| Fourth | 1,513,437 | 1,434,511 | |
| Yearly average | 1,410,581 | 1,400,383 | |
| Highest month | 1,562,208 | 1,545,416 | |
| Lowest month | 1,261,250 | 1,234,939 | |
| Barrels delivered | 514,862,000 | 511,140,000 | |
| Barrel miles (millions) | 689,874 | 679,916 | 1% |
| Number of employees—December 31 | 791 | 798 | |

**FINANCIAL** (in millions of dollars)




**STATISTICAL**



In 1978 earnings increased by 7% over 1977 to $46.8 million or $1.83 per share. The improved earnings were largely the result of the gain in foreign exchange on earnings of the U.S. subsidiary, Lakehead Pipe Line Company, Inc., and the absence of large capital write-offs which occurred in 1977.

Operating results showed a modest improvement over 1977. Total deliveries of 515 million barrels of crude oil, natural gas liquids and refined products were equivalent to 1.4 million barrels per day. This volume is slightly higher than the 511 million barrels delivered in 1977. Barrel miles increased by 1.5% to 690 billion.

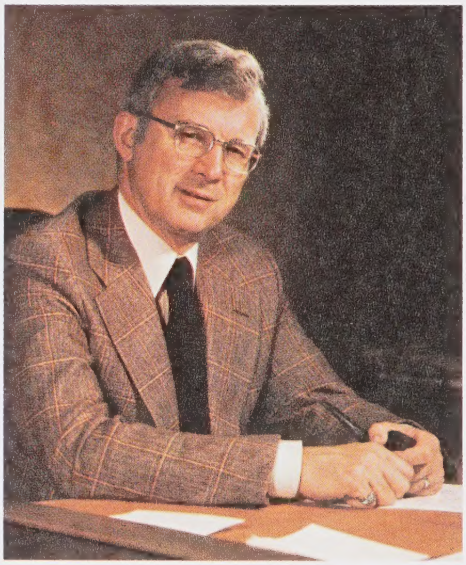
Deliveries to refineries in Eastern Canada increased by 56,000 b/d while deliveries to U.S. refineries declined by 42,000 b/d to 408,000 b/d. About half of the U.S. deliveries were of U.S. or offshore origin and the balance was Canadian licensed exports and oil exchanges. The exchanges involved deliveries of domestic crude to northern tier refineries for an equal volume of foreign crude delivered to Eastern Canadian refineries. Exports of heavy crude oil, which were surplus to Canadian requirements, were the same as last year at 117,000 b/d.

Synthetic crude from the new Syncrude oil sands plant was received at Edmonton in September. Although receipts were limited as a result of initial plant start-up problems, the volume is expected to increase to 125,000 b/d in 1979 as Syncrude reaches design capacity.

Deliveries to the new refinery at Nanticoke, Ontario started in May but normal operations did not begin until November.

As a result of a change in Canadian government policy deliveries to Montreal increased from 250,000 b/d to 315,000 b/d by year-end. A yearly average of 275,000 b/d was pumped through the Montreal Extension with a peak of 337,000 b/d reached in December.

The 1978 Iranian crisis reduced world crude oil supplies and affected the requirements for the company's transportation service. In Eastern Canada the demand for Canadian crude increased to the extent that refinery requirements exceeded pipe line capacity by approximately 100,000 b/d. Starting in December and continuing through the first quarter of 1979, it has been necessary to apportion pipe line capacity upstream of Sarnia.



R. K. Heule, President

Following the conclusion of the lengthy rate hearing concerning the justness and reasonableness of tariffs charged in Canada, the National Energy Board issued its decision on the determination of appropriate tariffs in May. As discussed in the section on Rate Regulation the company's tariffs are now regulated on a historical cost rate base.

In general, the findings of the NEB's report on Canada's long term oil supply and requirements issued in September were encouraging. Its major conclusions were:

—deliveries of Canadian oil to Montreal could be increased to a 315,000 b/d level for the next five years, gradually reducing thereafter;

—exports of light crude could be maintained at a 55,000 b/d level for three additional years instead of phasing out at the end of 1979;

—heavy crude surplus to Canadian requirements should continue to be exported.

These findings were more optimistic than the NEB's 1977 report on the estimated Canadian supply of crude available for Eastern refineries reassuring a continued use of the company's facilities.

Probable development of additional oil sand reserves is encouraged by the announcement of plans for a third Athabasca oil sands plant by the Alsands project group managed by Shell Resources and the proposed Cold Lake heavy oil project by Imperial Oil.

### Rate Regulation

Following the December 1977 decision of the NEB on the allowable revenues that the company may recover in its transportation rates in Canada, the company asked the NEB to review certain of its findings. In its review decision the NEB allowed changes which added over $5 million to the revenue level to which rates would be designed. The Board also decided that the net book value of certain of the idle facilities which it had ordered the company to amortize through the cost of service over five years should be allowed a return equal to one-half of the rate of return allowed on other assets in the rate base. However, the Board did not alter its allowed return on common equity from the 14% level, which the company believes is too low; nor did it change its original decision concerning the disallowance from recovery in rates of certain costs of construction on the Montreal Extension.

Phase III of the rate hearing considered the manner in which rates would be designed to recover the allowed revenues. The company was also permitted to update its rate base and cost of service for a forward "test year" commencing July 1, 1978. New tariffs filed effective July 1 were designed to reduce revenues by approximately 5% for the Canadian system, excluding the Montreal Extension. The approved rate structure for the Montreal Extension incorporates an upstream credit giving recognition to the effect of Montreal volumes on upstream revenues. This credit plus the revenue from the allowed rates for the Montreal Extension are insufficient to cover the fixed and variable costs of the Extension and as a result the Canadian government will pay the shortfall in revenue under the previously negotiated Deficiency Agreement.

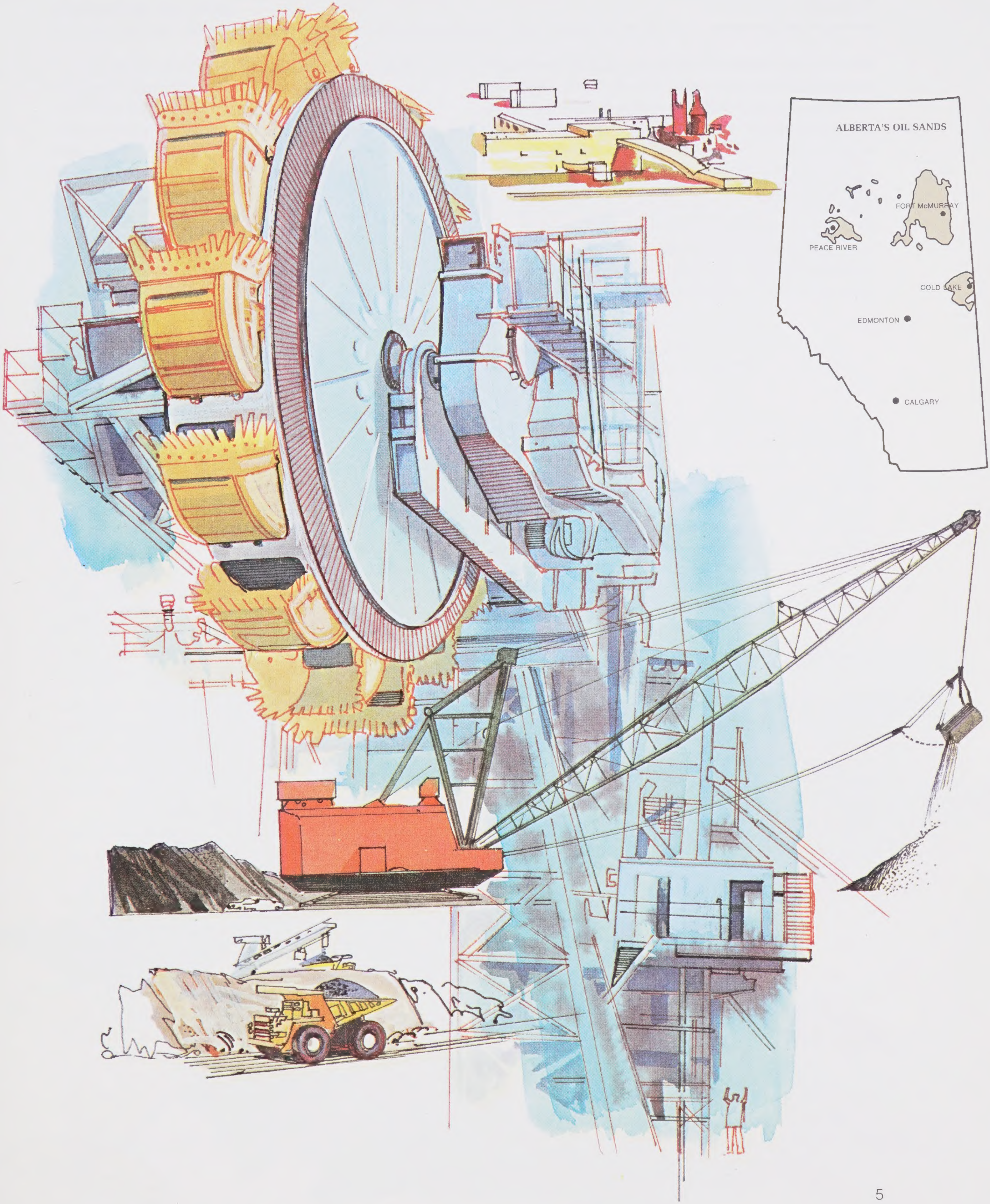
The NEB also instituted a new procedure which provides a degree of flexibility in adjusting tariffs in the future without the necessity of lengthy and costly hearings. This procedure will apply when adjustments in rates are required due to revisions in forecast throughput or cost and no changes are involved in either methodology or principles of rate design.

In the United States a generic hearing inquiring into the method of regulation of oil pipe lines was initiated in 1974 by the Interstate Commerce Commission. The hearing now being continued by the Federal Energy Regulatory Commission is concerned with the method of valuation and rate of return and is expected to continue for some considerable time.

On January 30, 1979 the FERC issued an order which instituted an investigation into the justness and reasonableness of Lakehead's transportation rates. Management is concerned by this announcement particularly since the Commission has not indicated what caused it to initiate the investigation.

### Kitimat Pipe Line Ltd.

The company continues as a participant in the Kitimat Pipe Line group interested in the construction of an oil pipe line from the West Coast port of Kitimat, B.C. to Edmonton. Although the NEB's oil supply report found that there was no Canadian need to augment existing port facilities in Canada, the Kitimat line would provide the U.S. Northern Tier refineries with a west coast access for Alaskan and offshore crude. Competing oil pipe line projects for transporting Alaskan crude to the U.S. Mid-west are being assessed by the U.S. federal government. The Kitimat pipe line application filed with the NEB is being held in abeyance and further activities have been held to a minimum.


ALBERTA'S OIL SANDS
FORT McMURRAY
PEACE RIVER
COLD LAKE
EDMONTON
CALGARY

## TARIFFS

The principal business of Interprovincial and Lakehead is the transportation of crude oil, natural gas liquids and refined products at established tariffs. Following the rate hearing new tariffs for transportation in Canada became effective July 1, 1978. Lakehead tariffs filed with the FERC were increased by 6% effective October 1 to partially compensate for the inflationary effects on operating costs. This is the first increase in Lakehead rates since April 1975. Lakehead's rates are now quoted in U.S. currency and Interprovincial's rates in Canadian currency. Combined rates for light crude from the three main receiving points to the principal delivery points are:

Rates for light crude in cents per barrel

| | From | | |
|---|---|---|---|
| To | Edmonton | Cromer | Chicago |
| Regina | 17.1¢ | — ¢ | — ¢ |
| Gretna | 27.9 | 8.7 | — |
| Clearbrook | 36.9 | 17.7 | — |
| Superior | 43.5 | 24.3 | — |
| Chicago | 56.8 | 37.6 | — |
| Sarnia | 61.7 | 42.5 | 16.6 |
| Toronto | 66.7 | 47.5 | 21.7 |
| Buffalo | 68.8 | 49.6 | 23.8 |
| Montreal | 84.7 | 65.5 | 39.6 |

The rates for heavier crude, natural gas liquids and refined petroleum products are slightly higher.

The Consolidated Financial Statements, Auditor's Report and accompanying Notes to the Financial Statements appear on pages 14 to 21 and include the accounts of Interprovincial and its wholly-owned subsidiaries. A ten-year review of selected financial and statistical information is shown on pages 22 and 23.

## Income

Total income for the year was $294 million compared with $279 million in 1977.

Transportation revenue increased by $24 million to $270 million of which $10 million was attributable to an increase in the Canadian dollar equivalent of Lakehead's U.S. dollar revenue. The U.S./Canadian exchange rate increased from $1.09 to $1.18 at year-end. Higher throughput to Ontario and Montreal refineries during the fourth quarter also contributed to the improvement in revenues.

Revenue receivable under the Montreal Extension Deficiency Agreement with the Canadian government amounted to $16.8 million compared with $29 million in the previous year. These amounts recover the excess of operating costs and other fixed expenses over the transportation revenue received on the Sarnia to Montreal Extension. The reduction in the 1978 deficiency payment resulted from the increase in the Sarnia to Montreal tariffs and from the imputed upstream credit which is allocated to the revenue of the Montreal Extension under order of the NEB.

Other income increased to $7.7 million from $4.8 million in the previous year. This was the result of increased cash available for short-term investments at higher interest rates and capital gains on the purchase of company debentures for future sinking fund requirements.

## Expenses

Energy expense continued to be the single largest cost for the company with power and fuel rates increasing significantly in Canada and the U.S. The conversion of Lakehead's energy costs to the Canadian dollar equivalent accounted for $2.8 million of the increase over 1977.

Other operating expenses were higher due principally to increased wages and related benefits.

The foreign exchange account reflects primarily the loss on settlement of U.S. dollar liabilities. However, these losses have been more than offset by the gain on translation of Lakehead's earnings to the Canadian dollar equivalent.

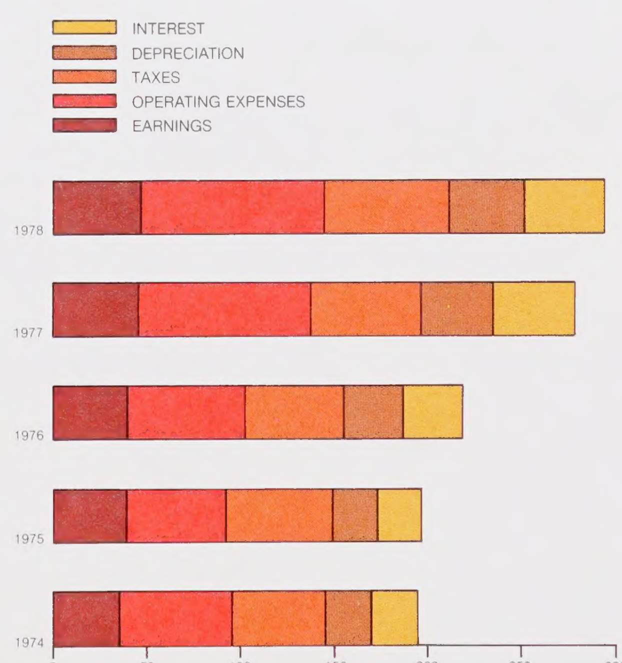
In 1977 $3.6 million was provided for the estimated loss on the discontinued Superior Products Terminal project. During the year negotiations were conducted with the two shippers involved and a settlement was reached whereby Lakehead recovered $2.2 million. This amount has been credited to earnings in the current year.

## Earnings and Dividends

Earnings for the year were $46.8 million or $1.83 per share compared with $43.8 million or $1.71 per share in 1977.

Dividends of $1.35 were paid to both Class A and Class B shareholders and included an extra dividend of ten cents per share paid on March 1. The regular quarterly dividend was increased from 30 cents per share to 32½ cents per share commencing with the September 1 dividend. Class B shareholders received tax-deferred dividends which were deemed to have been paid from 1971 capital surplus. The right to distribute tax-deferred dividends expired at year-end.

**DISTRIBUTION OF REVENUE** (in millions of dollars)



The total volumes of crude oil and other liquid hydrocarbons received and delivered by the pipe line system during the year were:

**Receipts—by location**
(thousands of barrels per day)

| | 1978 | 1977 |
|---|---|---|
| Alberta | 931.0 | 950.8 |
| Saskatchewan | 160.0 | 160.7 |
| Manitoba | 11.1 | 11.6 |
| Ontario | 7.6 | 2.5 |
| United States | 297.9 | 274.0 |
| | 1,407.6 | 1,399.6 |

**Deliveries—by location**
(thousands of barrels per day)

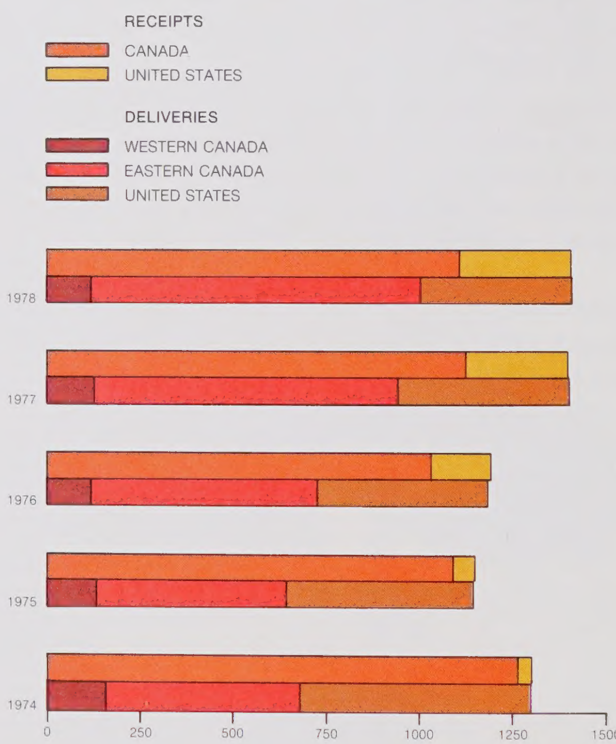
| | 1978 | 1977 |
|---|---|---|
| CANADA | | |
| Canadian Production | | |
| Prairie Provinces | 122.0 | 124.8 |
| Ontario | 539.9 | 539.7 |
| Montreal | 251.9 | 229.9 |
| | 913.8 | 894.4 |
| U.S. and Offshore Production | | |
| Ontario | 65.5 | 52.2 |
| Montreal | 23.1 | 3.0 |
| | 88.6 | 55.2 |
| TOTAL CANADIAN DELIVERIES | 1,002.4 | 949.6 |
| UNITED STATES | | |
| Canadian Production | | |
| Minnesota-Wisconsin | 145.2 | 179.0 |
| Illinois-Indiana | 12.3 | 15.6 |
| Michigan-Ohio | 29.6 | 33.1 |
| New York-Pennsylvania | 10.5 | 6.0 |
| | 197.6 | 233.7 |
| U.S. and Offshore Production | | |
| Minnesota-Wisconsin | 3.6 | 2.1 |
| Illinois-Indiana | 1.7 | — |
| Michigan-Ohio | 83.1 | 85.8 |
| New York-Pennsylvania | 122.2 | 129.2 |
| | 210.6 | 217.1 |
| TOTAL U.S. DELIVERIES | 408.2 | 450.8 |
| TOTAL DELIVERIES | 1,410.6 | 1,400.4 |

**Deliveries—by type**
(thousands of barrels per day)

| | 1978 | 1977 |
|---|---|---|
| CRUDE OIL | | |
| Light | 974.6 | 946.8 |
| Medium and heavy | 209.5 | 204.2 |
| Oil sands | 37.8 | 33.6 |
| NATURAL GAS LIQUIDS | | |
| Condensate | 60.8 | 67.9 |
| Propane/butane/condensate mix | 66.7 | 83.1 |
| REFINED PRODUCTS | 61.2 | 64.8 |
| | 1,410.6 | 1,400.4 |

The company converted its oil measurement practices to the metric system commencing January 1, 1979 in common with the Canadian petroleum industry. Under the International System of Units (SI) the cubic metre ($m^3$) became the new standard measure for oil replacing the barrel, with one cubic metre being equivalent to approximately 6.3 barrels. Using SI units in the tables above total deliveries expressed in thousands of cubic metres per day ($m^3/d$) would be 224.3 for 1978 and 222.6 for 1977.

**RECEIPTS & DELIVERIES** (thousands of barrels per day)



## 1978 CONSTRUCTION

Capital expenditures in 1978 totalled $9.4 million.

Construction of delivery facilities connecting the new 95,000 b/d Nanticoke refinery was completed. At Westover two additional tanks and a 2,000 h.p. pumping unit were installed to be used in conjunction with the 16-inch refinery delivery line completed late in 1977.

Additional valving is being installed on Line 1 between Edmonton and Gretna with completion scheduled for 1979. The modification program will upgrade this line to meet the latest operating regulations established for the pipe line transportation of high vapour pressure liquids.

Also completed was a new metering facility which eliminates the need for manual measurement at the two refineries at Oakville, Ontario.

### 1979 Forecast

Capital expenditures for new projects in 1979 are estimated at $24 million.

Ample reserve pumping capacity is available throughout the pipe line system to handle the volumes currently forecast for the next few years with the exception of the two lines delivering into Sarnia from Superior and Chicago. A continuation of the current high level of throughput requirements has necessitated further expansion in this section. A $14 million program adding 35 miles of 30-inch loops and a 2,500 h.p. electric station will increase capacity by 65,000 b/d (10,300 $m^3$/d).

Also included are two 390,000 barrel (62,000 $m^3$) tanks to be erected at Sarnia and one 217,000 barrel (34,500 $m^3$) tank at Griffith, Indiana. This tankage will permit segregating of additional crude types and improve operating flexibility.

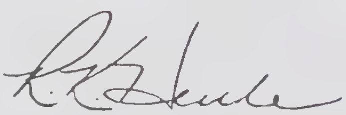
## GENERAL

David G. Waldon, Chairman of the Board, elected to take early retirement in September. Mr. Waldon has served as Chief Executive Officer since 1967 and retired with 43 years of service in the oil pipe line industry. Many of the company's achievements are due to his initiative and leadership. Our thanks and gratitude are extended for his many contributions.

During the year Messrs. J. W. Flanagan and J. G. Livingstone resigned from the Board. Their contributions and valuable service are sincerely acknowledged. Elected to fill Board vacancies were Mr. R. C. Gimlin of Toronto, President of Abitibi Paper Company Ltd., and Mr. J. C. Delorme of Montreal, President of Teleglobe Canada. Having reached retirement age, Mr. A. H. Lemmon will not be standing for re-election. His advice and counsel will be greatly missed.

The directors and management acknowledge the loyalty and continuing support of all employees and take this opportunity to express appreciation for their dedication, skill and high level of performance.

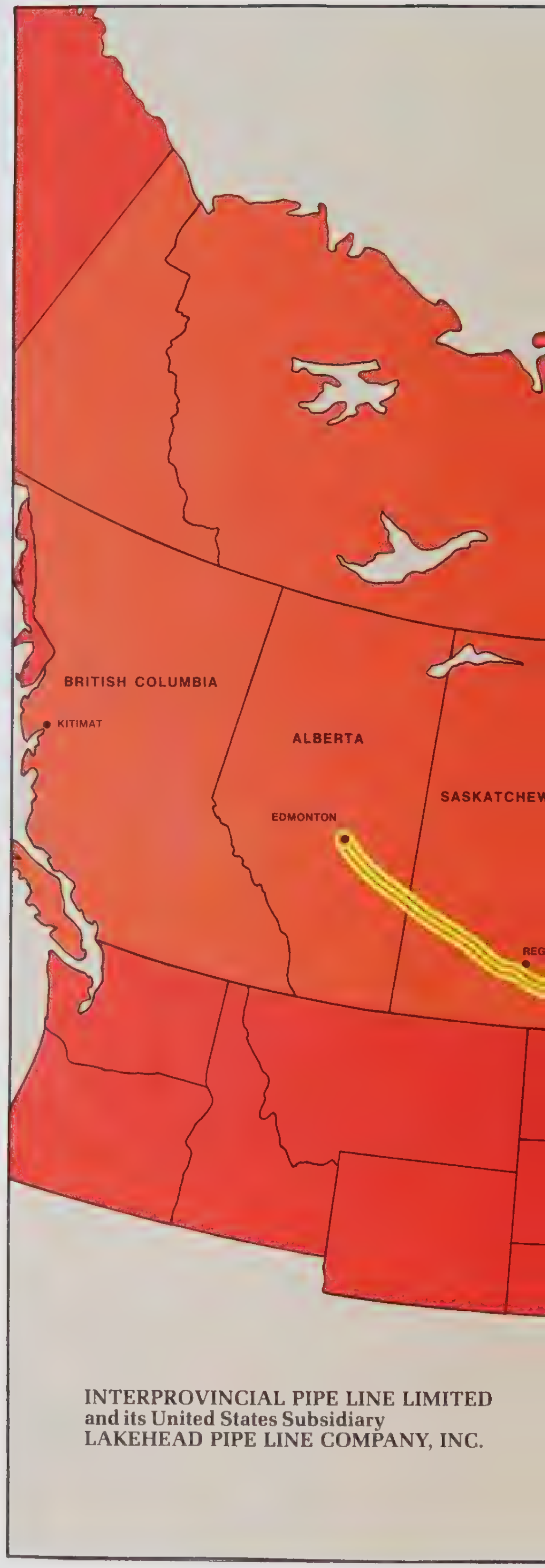
On behalf of the Board of Directors

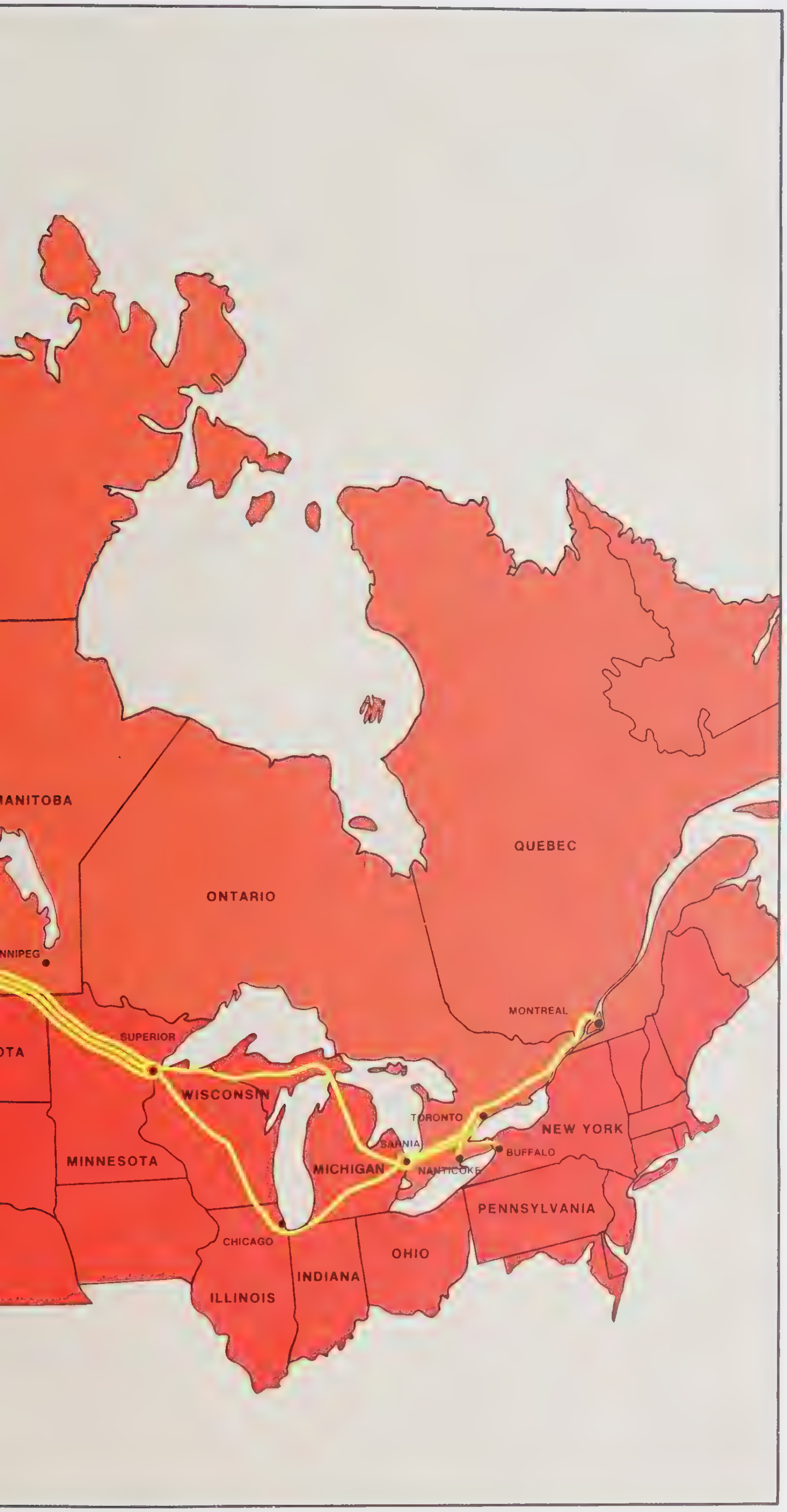


President

as at December 31, 1978

| | Canada | United States | Total |
|---|---|---|---|
| Miles of Right-of-Way | 1,417 | 1,739 | 3,156 |
| Number of Pumping Stations | 32 | 49 | 81 |
| Installed Horsepower | | | |
| —diesel | 34,320 | 42,200 | 76,520 |
| —electric | 512,270 | 413,500 | 925,770 |
| —total | 546,590 | 455,700 | 1,002,290 |
| Line Fill in Barrels (provided by shippers) | 13,771,000 | 11,921,000 | 25,692,000 |
| Separate Streams Transported | | | 43 |






## ANNUAL AVERAGE PHYSICAL CAPACITY

| Line Section | Thousands of Barrels per Day 1979 |
|---|---|
| Edmonton-Regina - - | 1,533 |
| Regina-Cromer - - | 1,466 |
| Cromer-Superior - - | 1,560 |
| Superior-Sarnia via Straits of Mackinac - | 555 |
| Superior-Chicago - - | 740 |
| Chicago-Sarnia - - | 710 |
| Sarnia-Port Credit - - | 470 |
| Westover-Nanticoke - | 110 |
| Westover-Buffalo - - | 160 |
| Sarnia-Montreal - - | 350 |

## MILES OF MAIN LINE PIPE

| Size | Canada | United States | Total |
|---|---|---|---|
| 12 inch - - | 66 | 26 | 92 |
| 16 - - - | 423 | — | 423 |
| 18 - - - | 39 | 325 | 364 |
| 20 - - - | 800 | 12 | 812 |
| 24 - - - | 772 | — | 772 |
| 26 - - - | 2 | 325 | 327 |
| 30 - - - | 531 | 989 | 1,520 |
| 34 - - - | 774 | 789 | 1,563 |
| 48 - - - | 224 | 106 | 330 |
| Total Miles of Main Line Pipe - - | 3,631 | 2,572 | 6,203 |

## TANKAGE: (thousands of barrels)

| | Number of Tanks | Capacity |
|---|---|---|
| Edmonton - - - - | 27 | 4,645 |
| Stony Beach - - - - | 3 | 66 |
| Regina - - - - - | 8 | 580 |
| Cromer - - - - - | 14 | 1,006 |
| Gretna - - - - - | 4 | 224 |
| Clearbrook - - - - | 7 | 474 |
| Superior - - - - - | 22 | 4,584 |
| Griffith - - - - - | 8 | 1,985 |
| Sarnia - - - - - | 15 | 2,250 |
| Westover - - - - - | 6 | 568 |
| | 114 | 16,382 |

## CONSOLIDATED STATEMENT OF EARNINGS (in thousands of dollars except per share amounts)

| | Year ended December 31 1978 | 1977 |
|---|---|---|
| *Income:* | | |
| Transportation revenue | **$269,989** | $245,699 |
| Montreal Extension Deficiency Agreement (Note 2) | **16,766** | 28,988 |
| Other income | **7,723** | 4,766 |
| | **294,478** | 279,453 |
| *Expenses:* (Note 1) | | |
| Operating—power and fuel | **56,428** | 47,424 |
| —other | **40,147** | 37,733 |
| Property and other taxes | **16,913** | 15,371 |
| Provision for depreciation and amortization | **39,580** | 38,479 |
| Interest on long term debt | **43,242** | 44,657 |
| Foreign exchange | **1,669** | 267 |
| Loss (recovery) on discontinued capital projects (Note 3) | **(2,158)** | 6,423 |
| | **195,821** | 190,354 |
| *Earnings before income taxes* | **98,657** | 89,099 |
| *Provision for income taxes:* (Note 1) | | |
| Current | **45,625** | 42,649 |
| Deferred | **6,989** | 2,823 |
| Deferred investment tax credits | **(767)** | (220) |
| | **51,847** | 45,252 |
| *Earnings for the year* | **$ 46,810** | $ 43,847 |
| *Earnings per share* (Note 1) | **$ 1.83** | $ 1.71 |

## CONSOLIDATED STATEMENT OF RETAINED EARNINGS (in thousands of dollars except per share amounts)

| | Year ended December 31 1978 | 1977 |
|---|---|---|
| *Balance at beginning of year* | **$157,952** | $144,793 |
| Earnings for the year | **46,810** | 43,847 |
| | **204,762** | 188,640 |
| Dividends paid—(per share: 1978—$1.35; 1977—$1.20) | **34,524** | 30,688 |
| *Balance at end of year* | **$170,238** | $157,952 |

## CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION (in thousands of dollars)

| | Year ended December 31 | |
|---|---|---|
| | **1978** | 1977 |
| *Source of Funds:* | | |
| Earnings for the year | **$ 46,810** | $ 43,847 |
| Add—Charges (credits) to earnings not affecting working capital: | | |
| Depreciation and amortization | **39,580** | 38,479 |
| Deferred income taxes | **6,989** | 2,823 |
| Deferred investment tax credits | **(767)** | (220) |
| Loss on discontinued capital projects | **—** | 6,423 |
| Other | **646** | 555 |
| Provided from operations | **93,258** | 91,907 |
| Long term debt issued | **—** | 50,500 |
| Other transactions | **1,327** | 1,999 |
| | **94,585** | 144,406 |
| *Use of Funds:* | | |
| Dividends | **34,524** | 30,688 |
| Additions to pipe line transportation system | **9,413** | 20,197 |
| Long term debt retired or included in current liabilities | **39,085** | 24,476 |
| Bank loans | **—** | 39,400 |
| Cost of issuing long term debt | **—** | 353 |
| | **83,022** | 115,114 |
| *Change in Working Capital* | **11,563** | 29,292 |
| *Working Capital at Beginning of Year* | **40,791** | 11,499 |
| *Working Capital at End of Year* | **$ 52,354** | $ 40,791 |

## CONSOLIDATED BALANCE SHEET (in thousands of dollars)

| ASSETS | December 31 1978 | 1977 |
|---|---|---|
| *Current Assets:* | | |
| Cash | $ 317 | $ 470 |
| Term deposits with Canadian chartered banks | 17,852 | 26,828 |
| Short term investments, at cost which is equivalent to market | 32,785 | 17,545 |
| Accounts receivable— | | |
| Transportation charges | 28,707 | 24,080 |
| Montreal Extension Deficiency Agreement (Note 2) | 18,779 | 28,857 |
| Other | 3,958 | 1,227 |
| Inventories— | | |
| Crude oil, at quoted market price | 7 | 1,427 |
| Materials and supplies, at cost | 5,812 | 5,475 |
| Prepaid expenses | 986 | 257 |
| | 109,203 | 106,166 |
| *Deferred Charges and Other Assets:* | | |
| Unamortized discount and expense on long term debt (Note 1) | 4,970 | 5,643 |
| Other | 5,270 | 6,807 |
| | 10,240 | 12,450 |
| *Pipe Line Transportation System,* at cost | | |
| (Notes 1 and 4) | 1,098,376 | 1,091,747 |
| Less—Accumulated depreciation and amortization | 367,725 | 331,166 |
| | 730,651 | 760,581 |
| | $ 850,094 | $ 879,197 |

*The financial statements have been approved by the Board:*

G. D. deS. WOTHERSPOON, *Director*

R. K. HEULE, *Director*

## LIABILITIES

| | December 31 1978 | 1977 |
|---|---|---|
| *Current Liabilities:* | | |
| Accounts payable | **$ 10,044** | $ 10,752 |
| Interest accrued | **11,723** | 12,731 |
| Income and other taxes | **18,881** | 25,546 |
| Current portion of long term debt | **16,201** | 16,346 |
| | **56,849** | 65,375 |
| *Long Term Debt* (Note 5) | **435,398** | 474,483 |
| *Deferred Income Taxes* (Note 1) | **128,923** | 121,934 |
| *Deferred Investment Tax Credits* (Note 1) | **10,811** | 11,578 |

## SHAREHOLDERS' EQUITY

| | 1978 | 1977 |
|---|---|---|
| *Capital Stock* (Note 6) | **25,573** | 25,573 |
| *Contributed Surplus*—premium on shares | **22,302** | 22,302 |
| *Retained Earnings* (Note 1) | **170,238** | 157,952 |
| | **218,113** | 205,827 |
| | **$850,094** | $879,197 |

## Auditors' Report

To the Shareholders of
INTERPROVINCIAL PIPE LINE LIMITED:

We have examined the consolidated balance sheet of Interprovincial Pipe Line Limited as at December 31, 1978 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Edmonton, Alberta
February 2, 1979

PRICE WATERHOUSE & CO.
Chartered Accountants

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies:

### Principles of Consolidation

The consolidated financial statements include the accounts of Interprovincial Pipe Line Limited and its wholly-owned United States subsidiary Lakehead Pipe Line Company, Inc. and its wholly-owned subsidiary, Pipe Line Service Company, Inc.

### Regulation

Interprovincial and Lakehead own and operate a pipe line system for the transportation of crude oil and other liquid hydrocarbons.

Interprovincial operates the Canadian section of the system under provisions of the National Energy Board Act. The National Energy Board has regulatory authority over such matters as construction, operations, accounting and rates. The NEB has issued its decision on Interprovincial's initial rate hearing in respect of determination of just and reasonable tolls. Interprovincial filed revised tariffs effective July 1, 1978, based on the Board's determination of appropriate historical cost rate bases, projected costs of service and rates of return.

Lakehead is an interstate common carrier within the meaning of the Interstate Commerce Act. The Federal Energy Regulatory Commission has regulatory authority over the rates, regulations, accounting and other practices of common carrier oil pipe lines. On January 30, 1979 the Commission announced that it has instituted an investigation of the tariffs of Lakehead. Neither the time required to resolve this matter, nor the ultimate effect on the company can be appraised at this time.

### Foreign Exchange

United States dollar amounts have been translated into Canadian dollars on the following bases:

Current assets and liabilities—
at the rate of exchange December 31;

Other assets and liabilities—
at historical rates of exchange except for accumulated depreciation which is translated on the basis of equivalent Canadian dollar cost of the related fixed assets;

Income and expenses—
at monthly rates of exchange except provision for depreciation which is translated on the same basis as the related fixed assets.

Net losses arising from the foregoing methods are included on the Consolidated Statement of Earnings as Foreign exchange.

### Discount and Expense on Long Term Debt

The balance of unamortized discount and expense is being amortized on the straight-line method over the life of the debt with adjustments as debt is retired. Amortization charged to earnings amounted to $673,000 in 1978 and $554,000 in 1977.

### Pipe Line Transportation System, Depreciation and Amortization

Expenditures for system expansion and major renewals and betterments are capitalized whereas maintenance and repair costs are charged to operating expenses as incurred.

In 1977, Interprovincial adopted the accounting practice of capitalizing at an annual rate of 9.65%, an allowance for interest and equity costs on funds required to finance construction work in progress in Canada. This practice has resulted in $365,000 and $185,000 being capitalized by Interprovincial in the years 1978 and 1977 respectively. Lakehead capitalizes interest during the construction period only when funds are borrowed for additions to the pipe line transportation system. Lakehead did not capitalize any interest during 1978 and 1977.

The companies provide for depreciation of fixed assets, excluding the Montreal Extension and Assets Specially Classified, on the straight-line method at annual rates which will amortize the costs of depreciable properties over their estimated service lives after taking into account possible salvage values. The rate of depreciation on these facilities averages approximately 3%.

In accordance with terms of the Deficiency Agreement with the Canadian Government (Note 2), Interprovincial is providing for depreciation of all Montreal Extension depreciable facilities on a 20-year straight-line basis.

The National Energy Board has directed that where initial expenditures for facilities which are presently not utilized were made in a prudent manner, the undepre-

ciated cost of these Assets Specially Classified should be amortized over a period of five years. As prescribed by the Board, effective July 1, 1978, Interprovincial commenced amortization of assets with an original cost of $26,013,000 and a net book value on that date of $14,740,000. This resulted in an additional charge to earnings during 1978 of $1,099,000.

When fixed assets are retired or otherwise disposed of, the cost and accumulated depreciation are cleared from the related accounts and any resultant profit or loss is credited or charged to accumulated depreciation, except for unusual disposals for which the profit or loss is included in earnings.

### Deferred Income and Withholding Taxes

The companies follow the tax allocation basis of accounting. Under Canadian and United States income tax regulations depreciation deducted for tax purposes may differ from the amount recorded in the accounts; also, during construction periods interest capitalized and, in the United States, sales taxes capitalized, may be claimed for tax purposes in the year incurred. The companies are using the maximum deductions permitted for tax purposes which result in deferment of taxes to future years when amounts deductible will be less than the depreciation recorded in the accounts.

Earnings of Lakehead are subject to a 15% U.S. withholding tax when paid as dividends to Interprovincial. It has not been considered necessary to provide for this tax on retained earnings of $66,471,000 U.S. of Lakehead at December 31, 1978 because they have been reinvested in that company.

### Deferred Investment Tax Credits

The United States subsidiary companies are allowed credits against income taxes payable of a specified percentage of the cost of most depreciable assets acquired and placed into service. These credits have been deferred and are being taken into earnings over the life of the related assets.

### Earnings per Share

Earnings per share are computed on the weighted average number of shares outstanding during the year. There would be no material dilution of earnings per share if the stock options had been exercised during the year.

### Pension Plans

Interprovincial and Lakehead have pension plans which cover substantially all employees. The principal amount of the unfunded liability for past service benefits, including experience deficiencies, was approximately $10,000,000 at December 31, 1977. This amount, together with interest, will be charged to earnings in varying annual installments to 1992. The companies fund accrued pension costs. In the years 1978 and 1977 total costs of the plans amounted to $2,812,000 and $2,581,000 respectively, of which $1,414,000 and $1,303,000 were applicable to past service benefits. At December 31, 1977 pension fund assets exceeded the actuarially computed value of the vested portion of the benefits.

## 2. Montreal Extension Deficiency Agreement:

Interprovincial and the Canadian Government are parties to a Deficiency Agreement whereby the Government will pay the deficiency if operating revenue in respect of the Extension is not sufficient to meet the fixed and variable costs of the Extension. Under the Agreement the Government has an option to purchase the Extension at its capital cost less depreciation, plus related expenses. The option is exercisable within 120 days following the date upon which a deficiency payment is made.

Tariffs prescribed by the National Energy Board in respect of the Montreal Extension do not produce sufficient operating revenue to meet the fixed and variable costs of the Extension and have resulted in a deficiency of $16,766,000 for the year 1978.

## 3. Superior Refined Products Terminal:

With the cancellation of construction of a refined products terminal at Superior, Wisconsin in 1976 and pending disposal of related materials and settlement with the two shippers involved as to their share of responsibility for the costs of cancellation, Lakehead charged $3,566,000 to earnings during 1977 as the estimated total provision for loss on the discontinued project. Settlement with the two shippers has now been negotiated and accordingly $2,158,000 has been credited to earnings in 1978.

4. Pipe Line Transportation System:
Accumulated Depreciation and Amortization:

The pipe line transportation system and accumulated depreciation and amortization by major classes were as follows:

| | Investment, at cost | Accumulated depreciation & amortization | Net investment December 31 | |
|---|---|---|---|---|
| | December 31, 1978 | | 1978 | 1977 |
| | (in thousands of dollars) | | | |
| Land | $ 3,039 | | $ 3,039 | $ 3,040 |
| Rights-of-way | 14,884 | $ 5,430 | 9,454 | 9,827 |
| Pipe line | 563,913 | 235,427 | 328,486 | 354,508 |
| Pumping equipment, buildings and tanks | 240,811 | 82,216 | 158,595 | 159,495 |
| Montreal Extension | 247,774 | 31,905 | 215,869 | 227,568 |
| Assets specially classified | 26,013 | 12,747 | 13,266 | |
| Construction in progress | 1,942 | | 1,942 | 6,143 |
| | $1,098,376 | $367,725 | $730,651 | $760,581 |

5. Long Term Debt:

Long Term Debt (excluding current portion) outstanding at December 31 was as follows:
(in thousands of dollars)

| | 1978 | 1977 |
|---|---|---|
| Interprovincial Pipe Line Limited | | |
| First Mortgage and Collateral Trust Bonds— | | |
| Series E—5½% due April 1, 1985 | $ 6,280 | $ 7,030 |
| Sinking Fund Debentures (unsecured)— | | |
| Series A—6% due November 1, 1986 | 21,000 | 22,400 |
| B—9⅜% due December 1, 1990 | 48,000 | 50,400 |
| C—8⅛% due May 1, 1993 | 44,000 | 45,749 |
| D—10⅜% due July 15, 1996 | 75,000 | 75,000 |
| E—10⅞% due February 1, 1996 | 75,000 | 75,000 |
| F—9⅝% due May 1, 1996 | 45,180 | 47,840 |
| Serial Debentures (unsecured)— | | |
| Series D—9¼%, $5,000 due annually July 15, 1979-1981 | 10,000 | 15,000 |
| E—9⅞%, $5,000 due annually February 1, 1979-1981 | 10,000 | 15,000 |

| | | |
|---|---|---|
| Lakehead Pipe Line Company, Inc. | | |
| Sinking Fund Debentures (guaranteed by Interprovincial)— | | |
| Series A—6½% due August 1, 1992 | | |
| (1978—$10,603 U.S.; 1977—$23,400 U.S.) | 11,415 | 25,192 |
| B—7⅛% due April 15, 1993 | | |
| (1978—$55,735 U.S.; 1977—$61,622 U.S.) | 60,011 | 66,350 |
| C—7.60% due June 15, 1997 | | |
| (1978—$29,990 U.S.; 1977—$30,000 U.S.) | 29,512 | 29,522 |
| | $435,398 | $474,483 |

The First Mortgage and Collateral Trust Bonds of Interprovincial are secured by charges on all its assets; no further Bonds may be issued.

Principal repayments required on Long Term Debt for the years 1980 through 1983 are $22,692,000, $25,356,000, $25,356,000 and $25,356,000 respectively.

Long Term Debt payable in U.S. currency translated at historical rates of exchange amounts to $100,938,000 and if translated at the December 31, 1978 rate of exchange would be $114,245,000.

### 6. Capital Stock:

| | Class A | Class B |
|---|---|---|
| Number of common shares, par value $1 each | | |
| Authorized | 100,000,000 | 100,000,000 |
| Issued— | | |
| December 31, 1978 | 24,585,257 | 988,373 |
| December 31, 1977 | 24,484,530 | 1,089,100 |

Each class of share is voting, convertible into the other on a share-for-share basis and ranks equally with respect to dividends and in all other respects except that, in declaring dividends on Class B shares, the Directors may provide for tax-deferred dividends to be paid out of either or both tax-paid undistributed surplus on hand or 1971 capital surplus on hand, both as defined in the Income Tax Act of Canada. If a dividend is declared on the Class A shares, the Directors must declare an equivalent dividend on the Class B shares.

Parliament enacted legislation effective March 31, 1977 amending income tax rules to permit companies to pay dividends out of 1971 capital surplus without having to pay the 15% tax on all their 1971 undistributed income. Effective June 1, 1977 Interprovincial's Class B dividends have been paid out of 1971 capital surplus. Corporations are not permitted to distribute tax-deferred dividends after December 31, 1978.

Under the Employee Incentive Stock Option Plan, options have been granted to full-time employees to purchase shares of capital stock at not less than 90% of market value of the shares on the day that the options were granted. These options have been granted for a term not exceeding ten years and are exercisable only after one year of employment from the date of grant. During 1978, options for 55,500 shares were granted and none were exercised and at year end no further shares were available for future grants. At December 31, 1978 options were outstanding on a total of 170,025 shares at prices ranging from $14.75 to $25.80 per share, exercisable over varying periods up to December 1988. Outstanding options include 56,500 shares to officers.

### 7. Remuneration of Directors and Officers:

In 1978 aggregate remuneration of eleven directors, one of whom was not paid as a director, was $52,000. Aggregate remuneration of six officers, two of whom are also directors was $430,000. No director or officer received remuneration from any subsidiary.

## TEN YEAR REVIEW

| Financial (in thousands of dollars except per share amounts) | 1978 |
|---|---|
| Income—Transportation revenue | $ 269,989 |
| —Deficiency Agreement | $ 16,766 |
| —Other income | $ 7,723 |
| Expenses—Operating—power and fuel | $ 56,428 |
| —other | $ 39,658 |
| —Property and other taxes | $ 16,913 |
| —Depreciation | $ 39,580 |
| —Interest | $ 43,242 |
| Income taxes | $ 51,847 |
| Earnings | $ 46,810 |
| per share, weighted average | $ 1.83 |
| Dividends paid | $ 34,524 |
| per share | $ 1.35 |
| percentage of earnings | 74% |
| Working capital (deficit) | $ 52,354 |
| Funds provided from operations | $ 93,258 |
| Additions to pipe line system | $ 9,413 |
| Investment in pipe line system (cost) | $1,098,376 |
| Long term debt | $ 435,398 |
| **Statistical** | |
| Shares outstanding at year end (thousands) | 25,573 |
| Percentage of shares registered in Canada | 95% |
| Shareholders at year end | 21,957 |
| Number of employees at year end | 791 |
| Investment in pipe line system, per employee | $1,389,000 |
| Receipts (b/d)—Alberta | 930,964 |
| —Saskatchewan | 159,969 |
| —Manitoba | 11,146 |
| —Ontario | 7,594 |
| —United States | 297,893 |
| | 1,407,566 |
| Deliveries (b/d) | |
| Canada—Prairie Provinces | 122,007 |
| —Ontario | 605,439 |
| —Quebec | 274,884 |
| | 1,002,330 |
| United States—Minnesota-Wisconsin | 148,851 |
| —Illinois-Indiana | 13,946 |
| —Michigan-Ohio | 112,768 |
| —New York-Pennsylvania | 132,686 |
| | 408,251 |
| | 1,410,581 |
| Barrel miles (millions) | 689,874 |
| Average mileage per barrel delivered | 1,340 |
| Average transportation revenue (including Deficiency Agreement) | |
| —per barrel | 55.7¢ |
| —per 100 barrel miles | 4.16¢ |

| 1977 | 1976 | 1975 | 1974 | 1973 | 1972 | 1971 | 1970 | 1969 |
|---|---|---|---|---|---|---|---|---|
| 245,699 | 196,712 | 194,715 | 192,944 | 202,831 | 164,207 | 144,393 | 133,707 | 114,465 |
| 28,988 | 20,209 | — | — | — | — | — | — | — |
| 4,766 | 3,725 | 2,300 | 2,074 | 2,461 | 1,689 | 2,871 | 1,643 | 994 |
| 47,424 | 30,902 | 27,550 | 31,603 | 30,699 | 18,735 | 13,213 | 11,186 | 11,053 |
| 44,423 | 30,924 | 26,491 | 27,277 | 22,075 | 18,088 | 17,176 | 16,164 | 14,841 |
| 15,371 | 12,675 | 12,588 | 11,218 | 8,415 | 9,612 | 8,814 | 9,643 | 8,338 |
| 38,479 | 32,224 | 24,889 | 24,044 | 21,803 | 19,674 | 18,115 | 17,519 | 16,070 |
| 44,657 | 34,399 | 23,273 | 24,724 | 21,481 | 19,010 | 18,890 | 18,810 | 13,898 |
| 45,252 | 40,407 | 43,323 | 40,567 | 53,034 | 40,693 | 35,416 | 32,531 | 26,833 |
| 43,847 | 39,115 | 38,901 | 35,585 | 47,785 | 40,084 | 35,640 | 29,497 | 24,426 |
| 1.71 | 1.53 | 1.52 | 1.39 | 1.87 | 1.57 | 1.40 | 1.16 | 0.96 |
| 30,688 | 30,688 | 30,688 | 30,688 | 28,127 | 23,976 | 21,892 | 20,352 | 18,316 |
| 1.20 | 1.20 | 1.20 | 1.20 | 1.10 | 0.94 | 0.86 | 0.80 | 0.72 |
| 70% | 78% | 79% | 86% | 59% | 60% | 61% | 69% | 75% |
| 40,791 | 11,499 | (22,575) | (16,695) | (4,800) | (707) | (818) | 31,848 | (10,490) |
| 91,907 | 87,876 | 78,859 | 69,193 | 84,230 | 70,510 | 61,719 | 52,825 | 49,137 |
| 20,197 | 113,587 | 151,202 | 31,192 | 94,056 | 66,022 | 44,783 | 17,795 | 70,595 |
| 1,091,747 | 1,085,984 | 978,725 | 828,725 | 801,416 | 708,688 | 646,172 | 602,312 | 587,340 |
| 474,483 | 487,859 | 396,588 | 296,554 | 315,874 | 282,142 | 264,279 | 292,829 | 265,184 |
| 25,573 | 25,573 | 25,573 | 25,573 | 25,573 | 25,527 | 25,476 | 25,443 | 25,439 |
| 95% | 93% | 95% | 94% | 94% | 94% | 93% | 93% | 92% |
| 21,942 | 20,359 | 21,010 | 20,423 | 19,621 | 18,864 | 19,576 | 21,066 | 21,996 |
| 798 | 790 | 755 | 751 | 730 | 706 | 677 | 641 | 603 |
| 1,368,000 | 1,375,000 | 1,296,000 | 1,103,000 | 1,098,000 | 1,004,000 | 954,000 | 940,000 | 974,000 |
| 950,782 | 873,220 | 924,151 | 1,059,695 | 1,134,985 | 877,474 | 743,411 | 659,382 | 542,093 |
| 160,632 | 145,968 | 148,053 | 192,951 | 217,423 | 217,768 | 217,034 | 224,890 | 225,755 |
| 11,594 | 11,215 | 12,215 | 13,193 | 14,216 | 14,931 | 15,575 | 16,452 | 17,489 |
| 2,500 | 1,556 | 1,596 | 842 | 4,134 | 3,196 | 2,751 | 817 | 550 |
| 274,066 | 166,712 | 76,393 | 42,241 | 11,123 | 8,440 | 3,228 | 2,579 | — |
| 1,399,574 | 1,198,671 | 1,162,408 | 1,308,922 | 1,381,881 | 1,121,809 | 981,999 | 904,120 | 785,887 |
| 124,796 | 123,510 | 137,479 | 155,755 | 147,033 | 115,939 | 116,163 | 116,386 | 111,504 |
| 591,919 | 527,536 | 510,167 | 524,805 | 467,893 | 414,305 | 390,798 | 380,570 | 351,270 |
| 232,884 | 83,723 | — | — | — | — | — | — | — |
| 949,599 | 734,769 | 647,646 | 680,560 | 614,926 | 530,244 | 506,961 | 496,956 | 462,774 |
| 181,087 | 172,004 | 166,274 | 169,435 | 195,467 | 175,534 | 159,142 | 142,686 | 135,451 |
| 15,573 | 24,971 | 81,782 | 164,324 | 229,302 | 145,397 | 89,309 | 49,836 | — |
| 118,907 | 120,857 | 141,311 | 165,119 | 200,978 | 142,973 | 120,098 | 121,822 | 105,540 |
| 135,217 | 131,050 | 123,185 | 127,639 | 136,742 | 121,365 | 101,840 | 89,619 | 72,206 |
| 450,784 | 448,882 | 512,552 | 626,517 | 762,489 | 585,269 | 470,389 | 403,963 | 313,197 |
| 1,400,383 | 1,183,651 | 1,160,198 | 1,307,077 | 1,377,415 | 1,115,513 | 977,350 | 900,919 | 775,971 |
| 679,916 | 579,436 | 581,850 | 668,864 | 707,037 | 573,456 | 488,862 | 444,318 | 366,287 |
| 1,330 | 1,338 | 1,374 | 1,402 | 1,406 | 1,405 | 1,370 | 1,351 | 1,293 |
| 53.7 | 50.1 | 46.0 | 40.4 | 40.3 | 40.2 | 40.5 | 40.7 | 40.4 |
| 4.04 | 3.74 | 3.35 | 2.88 | 2.87 | 2.86 | 2.95 | 3.01 | 3.13 |

## DIRECTORS

GEORGE A. BEVAN
Senior Vice-President
Shell Canada Limited, Toronto

LORENZ P. BLASER
Executive Vice-President & Director
Gulf Canada Limited, Toronto

GLENN H CURTIS
President & Director
Glenn H Curtis & Associates Limited, Toronto

JEAN-CLAUDE DELORME*
President, Chief Executive Officer & Director
Teleglobe Canada, Montreal

ROBERT C. GIMLIN
President & Director
Abitibi Paper Company Ltd., Toronto

JOHN H. HAMLIN
Senior Vice-President & Director
Imperial Oil Limited, Toronto

ROBERT K. HEULE
President & Chief Executive Officer
Interprovincial Pipe Line Limited, Toronto

**A. HAZLETT LEMMON
Chairman of the Board
The Canada Life Assurance Company, Toronto

**C. EDWARD MEDLAND
President, Chief Executive Officer & Director
Wood Gundy Limited, Toronto

DAVID G. WALDON
Retired, former Chairman of the Board
Interprovincial Pipe Line Limited, Toronto

**GORDON D. deS. WOTHERSPOON
Chairman of the Board
Eaton/Bay Financial Services Limited, Toronto

*Elected February 28, 1979
**Members of Audit Committee

## OFFICERS

ROBERT K. HEULE
President & Chief Executive Officer

JOHN BLIGHT, Vice-President Finance

DAVID C. FLEMING
Vice-President & General Manager

E. GORDON SHEASBY
Vice-President, General Counsel & Secretary

LAWRENCE W. BLAINE, Treasurer

FREDERICK B. NEWTON, Assistant Treasurer

JOHN B. McWILLIAMS, Assistant Secretary

## CORPORATE INFORMATION

EXECUTIVE OFFICE
1, First Canadian Place
Toronto, Ontario M5X 1A9

HEAD OFFICE AND OPERATING HEADQUARTERS
Toronto Dominion Tower
Edmonton Centre
Edmonton, Alberta T5J 2J9

STOCK TRANSFER AGENTS
The Royal Trust Company - Halifax, Montreal, Toronto, Winnipeg, Regina, Edmonton, Vancouver

Chemical Bank, New York

*(Change of address should be sent to the closest branch of the Transfer Agents)*

STOCK REGISTRARS
Montreal Trust Company - Halifax, Montreal, Toronto, Winnipeg, Regina, Edmonton, Vancouver

Bank of Montreal Trust Company, New York

DIVIDEND DISBURSING AGENT
The Royal Trust Company
P.O. Box 7500, Postal Station 'A'
Toronto, Ontario M5W 1P9

TRUSTEE AND REGISTRAR FOR FIRST MORTGAGE AND COLLATERAL TRUST BONDS
The Royal Trust Company
Toronto and Montreal

TRUSTEE AND REGISTRAR FOR SERIAL AND SINKING FUND DEBENTURES
Montreal Trust Company
Montreal, Toronto, Winnipeg, Edmonton and Vancouver

LISTING OF STOCK
Toronto and Montreal Stock Exchanges

AUDITORS
Price Waterhouse & Co.
Edmonton, Alberta

PRINTED IN CANADA